IN THE

Supreme Court of the United States

No. 46

THE UNITED STATES, PETITIONER,

v.

THE CAMBRIDGE LOAN AND BUILDING COMPANY

MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF

The undersigned Cleveland E. Cross and Herbert W. Nantz show to the court that they are counsel for the appellants in the cases of *The Home Savings and Loan Co. v. Commissioner of Internal Revenue*, and *The Henderson Savings and Loan Co. v. Commissioner of Internal Revenue*, now pending in the United States Circuit Court of Appeals for the Sixth Circuit on petition for review of the decisions of the United States

Board of Tax Appeals; that those cases present issues involving the construction of Sections 231 (4) of the Revenue Acts of 1918 and 1921, the decision of which will probably be ruled by the decision of this court in this case; that counsel for both parties have consented in writing to the filing by the undersigned of a brief *amici curiae*, and their consents have been filed with the clerk of this court.

Wherefore, the said Cleaveland R. Cross and Herbert W. Nauts pray leave to file herein and submit for consideration the following brief *amici curiae*:

ARGUMENT

I

The Term "Domestic Building and Loan Associations," as Employed in the Revenue Act of 1918, Includes Every Association Designated or Known as a Building and Loan Association by State Laws.

The Revenue Act of 1918, Title II, Part III, providing for corporation income taxation, contains the following:

> "Sec. 231. That the following organizations shall be exempt from taxation under this title * * *:
>
> (4) Domestic building and loan associations and co-operative banks without capital stock organized and operated for mutual purposes and not for profit;"

The statute quoted does not define "building and loan associations." In formulating a definition, it is important and even controlling to know what were gener

ally recognized as building and loan associations at the time of the enactment of the statute in question. The most fertile source of such information is found in the statutes of the several states providing for the organization and regulation of building and loan associations.

An examination of the state laws in force at the time of the enactment of the Revenue Act of 1918, and for some years previous thereto shows that building and loan associations were recognized as a special class of corporations in all the states. (Note 1.)

Note 1.

Ala., Ch. 69, Art. 17, code 1907;
Ark., Sec. 780, St. 1921;
Ariz., Title IX, Ch. 3, code 1913;
Calif., Sec. 648, Civ. code 1923;
Colo., Ch. XLIV, Comp. Laws;
Conn., Title XXXIV, Ch. 208, Gen. St. 1918;
Del., Ch. 65, Art. 3, code 1915;
Fla., Secs. 4207-4242, Rev. Gen. St.;
Ga., Secs. 2878-2882, code 1911;
Idaho, Ch. 200, Comp. St. 1919;
Ill., Ch. 32, Sec. 78, Rev. St. 1911;
Ind., Ch. 27, Art. 1, Burns' Ann. St. 1926;
Ia., Title XX, Comp. code 1919;
Kan., Ch. 17, Rev. St. 1923;
Ky., Sec. 854, Carroll's St.;
La., Secs. 760-784, Marr's Ann. Rev. St.;
Me., Ch. 52, Rev. St. 1916;
Md., Sec. 134, Art. 23, Ann. code 1911;
Mass., Ch. 170, A. L. 1921;
Mich., Ch. 191, Comp. L.;
Minn., Secs. 7740-7770, Gen. St. 1923;
Miss., Ch. 87, Hemingway's Ann. code 1917;
Mo., Ch. 90, Art. IX, R. S. 1919;
Mont., Part III, Ch. 24, R. C. 1921;
Neb., Title V, Art. XX, Comp. St. 1922;
Nev., Act of Mar. 24, 1915;
N. H., Ch. 290, Pub. L. 1926;
N. J., Comp. St., p. 333;
N. M., Ch. XV, St. 1915;
N. Y., Ch. 5, Secs. 375-420, Cahill's Cons. L.;
N. C., Ch. 91, Art. 15, St. 1919;
N. D., Ch. 26, Civ. code, Comp. L. 1913;
Ohio, Title IX, Div. IV, Ch. 1, Civ. code;
Okla., Ch. 34, Art. 7, Comp. St. 1921;
Oregon, Title XXXIX, Ch. V, L. 1920;
Penn., Sec. 2419, St. 1920;

In all states but two they were classified as business corporations or corporations for profit, having a capital stock divided into shares. In the two states referred to, Idaho and California, they apparently might be organized with or without capital stock. (Note 2.)

By the statutes of 43 of the states building and loan associations were expressly denominated as such. In Arizona and New York they were classified with and denominated savings and loan associations. In Massachusetts they were denominated co-operative banks. In Idaho they were denominated land and building corporations. In Vermont they were denominated co-operative savings and loan associations.

In addition to installment or running stock, associations were authorized to issue paid-up or prepaid stock in 23 states. (Note 3.)

R. I., Ch. 265, Gen. L. 1923;
S. C., Sec. 811, Art. 26, Civ. code;
S. D., Sec. 9066, Rev. code 1919;
Tenn., Sec. 2128, Ann. code 1917;
Tex., Ch. 25 A, Complete St. 1920;
Utah, Ch. 9, Title 19, Comp. L. 1917;
Vt., Ch. 229, Title 28, Gen. L. 1917;
Va., Ch. 166, Title 37, code 1919;
Wash., Secs. 4565-4598, code 1919;
W. Va., Sec. 2924, code 1913;
Wis., Ch. 93, St. 1919;
Wyo., Ch. 331, Comp. St. 1919.

Note 2.

Idaho, Sec. 3046, Comp. L.;
Calif., Sec. 6489, Civ. code 1923.

Note 3.

Ariz., Sec. 2121, code 1913;
Colo., Sec. 2792, Comp. L.;
Del., Sec. 1927, Rev. code 1915;
Fla., Sec. 4214, Rev. Gen. St.;
Ga., Sec. 2823, code 1911;
Idaho, Sec. 4006, Comp. St. 1919;
Ind., Sec. 5083, Burns' Ann. St. 1926;
Iowa, Sec. 5845, Comp. code 1919;
Kan., Sec. 2214, Gen. St. 1915;

In twelve states associations were expressly authorized to issue various other classes of stock, including permanent, preferred and guaranteed stock. (Note 4.)

Associations had the unrestricted power to borrow money in fourteen states. (Note 5.)

Ky., Sec. 856 (a), Carroll's St.;
La., Sec. 763, Ann. St.;
Md., Sec. 137, Ann. code 1911;
Mass., Sec. 12, A. L. 1921;
Minn., Sec. 7751, Gen. St. 1923;
Miss., Sec. 3916, Ann. code 1917;
Mo., Sec. 20201, R. S. 1919;
N. Y., Sec. 383, Cons. L.;
N. C., Sec. 5177, St. 1919;
Ohio, Sec. 9649, Gen. code;
Oregon, Sec. 6935, L. 1920;
R. I., Sec. 3903, Gen. L. 1923;
S. C., Sec. 4016, Civ. code 1922;
S. D., Sec. 9071, code 1919.

Note 4.

Ark., Sec. 1703;
Calif., Sec. 323, Civ. code 1923;
Del., Sec. 1927, code 1915;
Ga., Sec. 2823, code 1911;
Idaho, Sec. 4752, Comp. St. 1919;
Kan., Sec. 2214, Rev. St. 1923;
Ky., Sec. 856 (a), Carroll's St.;
La., Sec. 763, Marr's Ann. St.;
N. C., Sec. 5177, St. 1919;
R. I., Sec. 3903, Gen. L. 1923;
S. D., Sec. 9071, Rev. code 1919;
Tenn., Sec. 2051 (a) 1, Ann. code 1917.

Note 5.

Ark., Sec. 1717, St. 1921;
Calif., Sec. 325, Civ. code 1923;
Del., Sec. 2, Ch. 25, Art. 1, code 1915;
Ga., Sec. 2823, code 1911;
Idaho, Sec. 4907, Comp. St. 1919;
Ind., Sec. 5091, Burns' Ann. St. 1926;
La., Sec. 762, Marr's Ann. Rev. St.;
Md., Sec. 7, Art. 23, code 1911;
Mass., Sec. 16, Ch. 170, A. L. 1921;
Miss., Sec. 4073, Hemingway's code 1917;
N. D., Sec. 5131, Comp. L. 1913;
Oregon, Sec. 6926, L. 1920;
R. I., Sec. 3470-I, Gen. L. 1923;
Tenn., Sec. 2054, Ann. code 1917.

In eleven states the amount of money which might be borrowed was limited to a specified proportion of the assets, varying from 10% to 80%. (Note 6.)

In two states the amount of money which might be borrowed was limited to a specified proportion of the paid in capital. (Note 7.)

In four states the amount borrowed was limited to a specified proportion of the dues, installments or interest paid in. (Note 8.)

In Washington the amount of borrowed money was limited to a proportion of the loans made. (Note 9.)

In Pennsylvania an association might borrow an amount not exceeding 25% of its withdrawals. (Note 10.)

Note 6

Colo., Sec. 2795, Comp. L.;
Conn., Sec. 4017 (6), Gen. St. 1918;
Fla., Sec. 4221, Rev. Gen. St.;
Ill., Sec. 82 (b), Rev. St. 1911;
Kan., Sec. 861, Rev. St. 1923;
Minn., Sec. 2751, Gen. St. 1923;
Mont., Sec. 6358, R. C. 1917;
Ohio, Sec. 9656, Gen. code;
S. C., Sec. 824, Civ. code;
S. D., Sec. 9075, Rev. code 1919;
Wis., Sec. 2011, St. 1919.

Note 7

N. Y., Sec. 388, Cons. L.;
Penna., Sec. 2448, St. 1920.

Note 8

Mo., Sec. 10215, R. S. 1919;
N. C., Sec. 5184, Cons. St. 1919;
N. H., Sec. 13, Pub. L. 1926;
N. J., Sec. 19, P. S. 1903, p. 462.

Note 9

Wash., Sec. 4546, code 1919.

Note 10

Penna., Sec. 2450 St.

Associations are expressly given the power to receive deposits in seven states. (Note 11.)

Ten states permit associations without limitation to make loans to persons who are not members or stockholders. (Note 12.)

In nineteen states associations might loan to non-members funds which were not required by members. (Note 13.)

Note 11.

Ariz., Sec. 2122, code 1913;
Calif., Sec. 633, Civ. code 1923;
Minn., Sec. 7751, Gen. St. 1923;
Ohio, Sec. 9648, Gen. code;
Oregon, Sec. 6952, L. 1920;
S. C., Sec. 4004, Civ. code 1922;
S. D., Sec. 9067, Rev. code 1919.

Note 12.

Ariz., Sec. 2120, code 1913;
Ark., Sec. 1717, St. 1921;
Calif., Sec. 638, Civ. code;
Ga., Sec. 2878, code 1911;
Idaho, Sec. 4911;
Md., Art. 23, code 1911;
Miss., Sec. 3922, Hemingway's code 1917;
Mo., Sec. 10202, R. S. 1919;
Ohio, Sec. 9643, Gen. code;
Wash., Sec. 4565, code 1919.

Note 13.

Colo., Sec. 2794, Comp. L.;
Del., Sec. 2015, Rev. code 1915;
Fla., Sec. 4218, Rev. Gen. St.;
Ind., Sec. 5087, Burns' Ann. St. 1926;
Mass., Sec. 23, Ch. 170, A. L. 1921;
Mont., Sec. 6358, R. C. 1921;
N. H., Sec. 8, Ch. 166, L. 1901;
N. J., Sec. 24, V. Comp. St., p. 333;
N. M., Sec. 527, St. 1915;
N. Y., Sec. 388, Cons. L.;
N. D., Sec. 5120, Comp. L. 1913;
Okla., Sec. 5399, Comp. St. 1921;
Penna., Sec. 2456, St. 1920;
S. C., Sec. 824, Civ. code;
S. D., Sec. 9075, Rev. code 1919;
Tenn., Sec. 2144, Ann. code 1917;
Texas, Sec. 1313 cc, St. 1920;
Va., Sec. 4145, code 1919;
Wyo., Sec. 5217, St. 1919.

From the foregoing it will be seen that under the statutes of the several states regulating the organization and operation of building and loan associations their powers and practices vary considerably.

Their primary purpose is the same, to furnish the financial means to enable people to acquire homes. Their purpose is accomplished by accumulating from various sources funds which are lent to borrowers, in amounts comparatively large in proportion to the cost of the homes acquired, for long terms at a reasonable cost.

Their function could not be efficiently performed by banks or other financial institutions because of the limitations on the amounts which such institutions may invest for long periods on real estate security and because other institutions will not invest their funds in home loans at times when it is more profitable to use them otherwise.

For those reasons building and loan associations offer an advantageous and dependable means of financing home ownership which without them would not exist. It was because they so encouraged home ownership that they were given the tax exemption benefit, and for no other reason.

This clearly appears from the remarks of the senators who participated in the debate upon Section 231 (4) when it came up in the Senate on October 27, 1921. (Cong. Rec., Vol. 61, Part 7, pp. 6868-6872.)

Authorities generally have agreed that the public welfare is concerned with and promoted by citizens owning their own homes. Legislative enactments have consequently in many states granted financial inducements calculated to increase home ownership. Such induce-

ments have been occasionally provided directly for the home owner or builder. More frequently they have been granted directly to building and loan associations which were recognized as the most efficient agents for increasing home ownership. In many states associations have been favored over other corporations by whole or partial tax exemption. They have been generally exempted from the operation of usury laws. Frequently their incorporation fees or annual franchise fees have been reduced below the amounts paid by other corporations. Sometimes their shares have been exempted from taxation in the hands of the owners, and in some states the shares are exempt from execution. We have been able to find no reported case where a building and loan association has been denied any such privilege because of its special methods of operation, prior to the time the question was raised by the Treasury Department with respect to the federal income tax exemption. The privileges have been considered as categorical, and not subject to the special facts of each case.

Methods employed by associations in carrying out their purpose of assisting in the financing of homes will necessarily differ according to local real estate conditions, wealth and income of home purchasers, building conditions, money market, and other conditions. In addition to the simple lending of money to enable borrowers to acquire homes an association must incidentally engage in other activities. It must first of all obtain the funds with which to make its loans and which, obviously, must come largely from sources other than its borrowers. The association must offer to people with money to invest terms which will induce them to place their money with

the association rather than elsewhere. Funds may be raised by the sale of capital stock. Additional funds may be raised by accepting deposits from those who do not desire to become stockholders.

Methods of operation, depending largely on local conditions, are properly the subject of regulation by state laws. We do not believe that Congress was interested in such methods so long as they were consistent with the subject in which Congress was interested, namely, the encouragement of home ownership.

It is not on the principle of mutuality that they were exempted, or Congress would have expressly qualified them by that term, just as it did, in fact, in qualifying "mutual" savings banks, and "mutual" hail, cyclone, fire insurance companies, ditch or irrigation companies and telephone companies, all of which were likewise exempted by paragraphs (2) and (10) of Section 231.

Strict mutuality, in the sense that the term applies to a mutual insurance company, for instance, is impossible in the operation of a building and loan association. A mutual insurance company provides insurance to all its members and simply divides the cost among them. It does no business other than with its beneficiaries, who are its policy holders. *A building and loan association, on the contrary, must secure most of its funds from others than its beneficiaries, who are its borrowers, and who obviously could not furnish the funds to carry on its business or they would not be borrowers.* Unlike the mutual insurance company, which bears the same relation to all with whom it does business, the building and loan association is the creditor of one class with which it does business, and the debtor of the other class.

The only degree of mutuality which can be required of a building and loan association is that which will further its purpose. It exists when its borrowers participate equally in its benefits and when its transactions are with others to the advantage of its borrowers, to the extent possible under existing business conditions.

The government's contention that transactions by building and loan associations with non-stockholders are subversive of their purpose disregards the idea that loans to non-stockholders constitute an extension of that purpose and not a departure from it. That is, if it be in the interest of the public welfare that stockholders own their homes, it is difficult to perceive why the public welfare is not equally concerned that non-stockholders own their own homes, other conditions being equal.

II

If the Exemption Granted by Section 231 (4) of the Revenue Act of 1921 Be Construed in a More Limited Sense Than the Exemption Granted by the Corresponding Section of the 1918 Act, the More Limited Exemption Should Not Be Given Retrospective Effect.

The argument set forth above, in regard to the construction of Section 231 (4) of the Revenue Act of 1918 is, in the main, applicable to the corresponding section of the 1921 Act. However, if the exemption provided by the 1921 Act should be held to be of narrower application than that of the 1918 Act, we submit that the status of the associations for the period between January 1, 1921,

and November 23, 1921, is determined by the 1918 Act and not by the 1921 Act, as contended by the government. The relations between the associations and their borrowers in cases where loans were made during the period between the two dates mentioned were fixed by their contracts, and the associations had no control over such relations after the contracts were entered into.

An association had no power to compel a borrower to become a stockholder after it had made him a loan as a non-stockholder.

Congress must have had this situation in view at the time the 1921 Act was adopted. From the debates in the Senate relating the Section 231 (4) of the 1921 Act, heretofore referred to, it is apparent that there existed no intention to make the change, if any change were contemplated, retrospective to the first of the year.

The language of Section 231 (4) as finally enacted was that contained in the committee amendment to the bill received from the House, which, after attempts to change it in the Senate, was finally passed in the form reported by the finance committee.

Respectfully submitted,

CLEAVELAND R. CROSS,
HERBERT W. NAUTS.